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Canada Enacts the OECD-Sponsored Multilateral Instrument

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Canada has enacted into law the OECD-sponsored *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI). The enactment of June 21, 2019 represents the penultimate step in the domestic ratification of the MLI in Canada, which will be completed by the issuance of an order in council authorizing the signing of the instrument of ratification. Canada is expected to notify the OECD within the next few months that it has ratified the MLI.

As ratification and notification are essentially formalities, the MLI may enter into effect with respect to those of Canada's bilateral tax treaties designated as "covered tax agreements" (CTAs) as early as January 1, 2020, for withholding tax purposes and April 1, 2020, for tax years beginning on that date, for all other purposes.

The MLI is not a stand-alone tax treaty; rather, it implements certain treaty measures outlined in the OECD's Base Erosion and Profit Shifting (BEPS) initiative without the need for treaty-by-treaty bilateral negotiations and implementation. The MLI requires participating countries to agree to BEPS minimum standards with respect to anti-treaty shopping and dispute resolution measures, as well as permitting the adoption of a number of optional tax treaty provisions.

Canada has listed 75 of its 93 tax treaties as CTAs, each of which will be affected by the MLI if Canada and the relevant CTA partner (which has reciprocally listed its tax treaty with Canada as a CTA) ratify the MLI under their respective domestic laws. Notably, Canada's ratification of the MLI will not affect its treaty with the United States, which has not signed the MLI. That treaty already has complex, detailed arrangements, including a mandatory binding arbitration provision and a detailed "limitation on benefits" clause (LOB). The list of CTAs also does not include Germany and Switzerland, even though Germany and Switzerland are signatories to the MLI. Canada has, however, announced that it is commencing bilateral renegotiation of its treaties with Germany and Switzerland.

Upon signature of the MLI in 2017, Canada indicated that it would adopt the OECD-agreed minimum standards on treaty abuse and dispute resolution and the mandatory binding arbitration provisions. Canada also initially entered reservations rendering most optional MLI provisions inapplicable to its CTAs. On May 28, 2018, however, Canada announced its intention to remove certain reservations and adopt the following four optional MLI provisions, which are now part of the implementing legislation:

- a 365-day holding period ensuring that lower treaty-based rates of withholding tax on dividends will be made available only for companies holding shares for over 365 days (article 8);
- a 365-day lookback testing period for the purposes of determining whether capital gains on a sale of shares (or similar rights in an entity) that do not derive a certain percentage of their value from real or immovable property are exempted from tax (article 9);
- a provision on methods of resolving dual-resident entity cases (article 4); and
- a provision intended to allow treaty partners to move from a tax exemption system to a foreign tax credit system as their method of providing relief for double taxation (article 5).

With respect to the OECD-agreed minimum standards relating to entitlement to treaty benefits, Canada has opted for the principal purpose test (PPT). The PPT is a general anti-abuse rule that considers whether one of the principal purposes of an arrangement or transaction is to obtain treaty benefits in a way that is not in accordance with the object and purpose of the relevant treaty provisions. The federal government has announced its intention, where appropriate, to negotiate the inclusion of detailed LOB provisions in its treaties on a bilateral basis either in addition to or in replacement of the PPT. The OECD commentary on the PPT is not particularly instructive, and the scope and effect of the PPT currently is a matter of great interest and uncertainty in international tax planning.

The federal government did not announce an intention to remove its reservation on article 7(4), which would specifically allow treaty benefits that would otherwise be denied under the PPT to be granted in full or in part by the competent authorities in appropriate circumstances. Given the very broad language of the PPT, this reservation may be problematic for private equity and other collective investors that may be resident in multiple jurisdictions.

Upon ratification of the MLI, it will now no longer be possible for Canada to add further reservations limiting the application of the MLI to its CTAs. However, it may remove reservations to render applicable previously inapplicable optional provisions of the MLI. Thus, even after ratification, additional MLI provisions may enter into force and affect certain CTAs.

Foreign investors in Canada should review their arrangements in light of the anticipated coming into effect of the MLI in respect of Canada's CTAs.

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